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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

Application 12-04-019
(Filed April 23, 2012)

ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE'S RULING

Summary

Within 10 days from the date of this ruling, responses to the data requests in Attachment 1 shall be filed and served by California-American Water Company, the Monterey Regional Water Pollution Control Agency, and the Monterey Peninsula Water Management District. Other parties may, but are not required, to file and serve a response but a response, if any, shall be filed and served within 10 days from the date of this ruling. Within 10 days of the date of this ruling, all parties may, but are not required, to file and serve comments to assess and address the concerns stated in Attachment 2. Within 15 days of the date of this ruling, any party may, but is not required to, file and serve (a) comments on the responses to the data requests with respect to Attachment 1, and/or (b) reply comments regarding the comments with respect to Attachment 2.

1. Background

This proceeding is currently scoped to proceed in two phases. Phase 1 addresses issues regarding a Certificate of Public Convenience and Necessity

(CPCN) for the Monterey Peninsula Water Supply Project (MPWSP). Phase 2 addresses matters related to the Pure Water Monterey Groundwater Replenishment Project (GWR). If GWR continues to proceed forward, California-American Water Company (Cal-Am or applicant) may be able to sign a water purchase agreement (WPA) with the Monterey Regional Water Pollution Control Agency (Agency) and the Monterey Peninsula Water Management District (District) to purchase water from the GWR.

The schedule adopted in November 2015 keeps the two phases on a parallel track. As provided in the schedule:

The Commission's goal is to reach a single, comprehensive decision on all issues within this application. That decision will address all necessary matters including, but not limited to, the CPCN for the MPWSP, the WPA, and the certification of the Final Environmental Impact Report for the MPWSP.

The Commission does not intend to prepare a separate decision for Phase 2, and the adopted schedule does not anticipate that eventuality. Nonetheless, the adopted schedule recognizes that more than one decision may later become desirable. While the adopted schedule does not anticipate a separate Phase 2 decision, parties may file motions for a separate Phase 2 decision at the time of Phase 2 reply briefs (or at another reasonable time) if a separate decision can be argued to be reasonable and necessary (particularly if the Phase 1 schedule has lagged). Any party making such motion must be prepared to explain how the Phase 1 and Phase 2 issues, which appear to be substantially if not inextricably intertwined, would be reasonably and fairly treated in separate decisions." (November 17, 2015 Ruling at 11.)

The schedule included dates for the service of proposed testimony (in December 2015, January 2016, and March 2016) on remaining matters in Phases 1 and 2, with evidentiary hearings set to begin on April 11, 2016. (See Rulings

dated November 17, 2015 and March 30, 2016.) The proposed testimony has been served consistent with the adopted schedule. No motion for a separate Phase 2 decision has been filed.

The served proposed testimony includes discussion of various aspects of the GWR and WPA. (See, for example, proposed testimony of Svindland, Linam, MacLean, Burnett, Sciuto, Imamura, Holden, Nellor, Stoldt, Bruce, Moore, Rose, Minton, Weitzman). A copy of the draft WPA is also provided. (See, for example, proposed testimony of MacLean (Attachment 1), Stoldt (Attachment 4).)

On March 17, 2016, the Commission notified parties of a revised schedule for the MPWSP environmental impact report (EIR). Among other reasons for the revision, the environmental review will now be completed in a joint document between the state and federal governments. It will also use an updated project description provided in an amended application filed by applicant on March 14, 2016.

2. Discussion

The GWR continues to advance, while the schedule for the MPWSP has been necessarily delayed due to a variety of factors. No motion for a separate Phase 2 decision has yet been filed, but we acknowledge that parties are free to file such a motion. We have determined that it would likely be unwise for the Commission to wait until the conclusion of hearings and briefing on the MPWSP, and an eventual motion regarding the timing of the Commission's proceeding regarding the WPA, before giving consideration to the possibility of a separate and earlier decision on the WPA application.

The draft WPA and proposed direct testimonies present both many interesting possibilities but also some concerns. For example, several witnesses

identify advantages to the GWR and WPA. These include (but are not limited to): a completed and certified Final EIR that is no longer subject to judicial challenge, the potential for delivery of water before deliveries become available from the MPWSP, and a more diversified and resilient portfolio for water supply (compared to reliance solely on one larger desalination plant). Other witnesses identify concerns. These include (but are not limited to): prices, the applicant's request for regulatory preapprovals of costs without a cost cap, water quality, and public acceptance.

More information is needed before the Commission can make an informed decision on the WPA. Parties should develop that information now. Attachment 1 lists the information that the Commission would like parties to present.

Further, we want to surface potential concerns now, so that parties have time to consider and address these concerns. Attachment 2 states concerns that parties should consider and address now.

The promise of a successful GWR is remarkable. It can provide both purified potable water for domestic use, as well as a supply for irrigating one of the state's most fertile agricultural areas. The project would be the first of its kind to use not just wastewater, but also use stormwater, food industry processing water, and impaired surface waters. It offers substantial potential benefits including: a pure source of water; protection against droughts; a regional water supply solution; assistance against seawater intrusion into the Seaside Basin; the potential of cost-effective local control; protection of the Monterey Bay Sanctuary; a relatively low carbon footprint; and the provision of a

sustainable, resilient supply. It may yield up to 3,500 acre-feet per year for the Monterey Peninsula, and up to 5,000 acre-feet per year for the Salinas Valley.¹

With that said, parties should understand the data requests and concerns in Attachments 1 and 2 do not assume whether the projected water production will be realized, or prejudice the rate requests in light of the Commission's ratemaking authority and duties. The purposes of Attachments 1 and 2 are to gather more information to enable a more informed decision, and to surface potential concerns early in the Commission's review process so parties can assess and address the concerns.

IT IS RULED that:

1. Within 10 days from the date of this ruling, responses to the data requests in Attachment 1 shall be filed and served by California-American Water Company, the Monterey Regional Water Pollution Control Agency, and the Monterey Peninsula Water Management District. Other parties may, but are not required, to file and serve a response but a response, if any, shall be filed and served within 10 days from the date of this ruling.

2. Within 10 days of the date of this ruling, all parties may, but are not required, to file and serve comments to assess and address the concerns stated in Attachment 2.

3. Within 15 days of the date of this ruling, any party may, but is not required to, file and serve (a) comments on the data responses with respect to

¹ Pure Water Monterey GWR Project, Consolidated Final EIR, October 2015, page S-3. Also "The Future of Water is Here," PureWaterMonterey.org, December 2014.

Attachment 1, and/or (b) reply comments regarding the comments filed with respect to Attachment 2.

Dated April 8, 2016, at San Francisco, California.

/s/ GARY WEATHERFORD

Gary Weatherford
Administrative Law Judge

/s/ CATHERINE J.K. SANDOVAL

Catherine J.K. Sandoval
Assigned Commissioner

ATTACHMENT 1

DATA REQUEST

The California Public Utilities Commission (Commission or CPUC) would like the information identified in the following data requests. California-American Water Company (Cal-Am or Company), the Monterey Regional Water Pollution Control Agency (Agency) and the Monterey Peninsula Water Management District (District) shall provide the information requested in each data request to the fullest extent reasonably known by each party. Other parties may, but are not required to, provide answers.

1. Pipeline to bring water from the Pure Water Monterey Groundwater Replenishment Project (GWR) to the Cal-Am water delivery system.
 - a. Is a pipeline needed to bring water from the GWR to Cal-Am?
 - b. Please describe that pipeline. Is it from the Seaside Groundwater Basin to the Cal-Am system in Pacific Grove?
 - c. What is the status of that pipeline? Designed? All necessary land rights and permits obtained? In construction?
 - d. Who will own that pipeline?
 - e. Are there any regulatory steps to complete before the pipeline is built and operational?
 - f. Was the pipeline analyzed in the environmental impact report for the GWR?
 - g. If not yet built and operational, what are the projected dates for pipeline construction and operation?
 - h. Please provide any and all other information necessary for the Commission to have a reasonably complete understanding of how and when Cal-Am could take possession of GWR water on Cal-Am's system for provision to Cal-Am's customers.

2. Budgets (1/14/16 Draft WPA, Section 15)

The 1/14/16 draft Water Purchase Agreement (WPA) states that by May 1 of each year, the Agency and District shall estimate the fixed and variable costs for the next fiscal year. The estimates shall be available for review by the Agency, District, and Cal-Am for at least 15 days prior to adoption by the Board of the Agency and the Board of the District. (1/14/16 Draft WPA Section 15.)

- a. Please describe and explain the technical and legal process used, or contemplated to be used, by the Agency and District to adopt the annual budget described in Draft WPA Section 15.
- b. In particular, does the process include access to, and review of, those estimates (including all underlying workpapers, computer programs, and assumptions) by the public (e.g., customers of Cal-Am, Public Trust Alliance, Public Water Now, Water Plus, Monterey County Farm Bureau, Landwatch, Planning and Conservation League, Coalition of Peninsula Businesses), other governmental entities or agencies (e.g., Commission's Office of Ratepayer Advocates, CPUC legal and advisory staff), and other interested persons (e.g., press)?
- c. Are the estimates presented by Agency and District witnesses in an open, public evidentiary hearing, with the witnesses subject to cross-examination?
- d. Are witnesses with contrary estimates or views allowed to present their evidence and expert opinion, subject to cross-examination?
- e. Does the process include the opportunity to present legal briefs?
- f. Are the budgets adopted by the Agency and District in the form of formal, written decision?
- g. What is the process for appeal of each Agency and Board final decision?

3. True-Up (1/14/16 Draft WPA, Section 16)

The 1/14/16 draft WPA provides that "there will be a 'true-up' or reconciliation at the end of every Fiscal Year following the Performance Start

Date to ensure the principles set forth in this section are met.” (1/14/16 Draft WPA Section 16.)

- a. What are the principles set forth in this section?
- b. As with a prior question (regarding the budget), please describe and explain the technical and legal process used, or contemplated to be used, by the Agency and District for this true-up or reconciliation. Please explain the due process protections that are contemplated (e.g., all relevant material available for public review and comment; evidentiary hearing; witnesses subject to cross-examination; legal briefs; formal decision; appeal process of formal decision).

4. Access to books and records (1/14/16 Draft WPA, Section 18)

The 1/14/16 draft WPA states that “access to the books and records of the Agency and the District will be made available to the Company for purposes of reviewing the accuracy and reasonableness of all costs relating to the Project and determination of the Company Water Rate.” (1/14/16 Draft WPA, Section 18.)

- a. What if any provisions are there for persons or entities other than the Company to access the books and records of the Agency and the District for the purposes stated above? Will the Commission have access to the books and records of the Agency and District?

5. Rate Determined by water produced (1/14/16 Draft WPA, Section 16)

The 1/14/16 draft WPA states that the Company Water Rate in each Fiscal Year shall be the sum of the budgeted fixed and variable costs for that fiscal year “divided by the amount of AWT [advanced water treatment] Water expected to be produced during the Fiscal Year.” (1/14/16 Draft WPA, Section 16.)

- a. Please explain the provisions, if any, to “true-up” or reconcile the calculated rate to account for actual water produced (as opposed to expected water to be produced) during the fiscal year.
- b. Please explain the provisions, if any, to “true-up” or reconcile the calculated rate to account for lost water (produced but not delivered to Cal-Am), if any.
- c. Please explain the provisions, if any, to “true-up” or reconcile the calculated rate to account for other relevant effects, if any.

6. Requirements of law (1/14/16 Draft WPA, Section 16)

The 1/14/16 Draft WPA states that:

“The Parties agree that, given the status of the Agency and the District as governmental agencies and the requirements under law that they incur only reasonable and prudent costs and expenses for purposes related to their governmental duties and the fact that such costs and expenses are subject to public review and scrutiny, all Fixed Project Costs and Project Operation and Maintenance Expenses incurred by the Agency and the District in compliance with the terms of this Agreement shall be deemed reasonable and prudent...” (1/14/16 Draft WPA, Section 16.)

- a. Please cite the law and/or laws requiring that the Agency and the District only incur reasonable and prudent costs and expenses.
- b. Please explain the technical and legal process to address and adjudicate a potential dispute if a person or party believes the Agency or District has incurred an unreasonable and/or imprudent cost or expense.
- c. To the extent not fully answered in responses to data requests above (regarding budgets, true-up, access to books and records), please explain how all project costs and expenses are subject to public review and scrutiny.
- d. To the extent not fully answered in responses to data requests above, please analyze whether the process is consistent with the Commission’s jurisdiction and ratemaking authority and duties.

7. Cost recovery assurance from other customers

The two purposes of the GWR are to: (a) produce up to 3,500 acre-feet per year (AFY) for California-American Water Company and (b) provide additional recycled water for use in the Castroville Seawater Intrusion Project's agricultural irrigation system. It is anticipated that approximately 4,500 to 4,700 AFY could be created for agricultural use in normal and wet years, and as much as 5,900 AFY in drought years.²

- a. It appears that about 40% of the project will be for Cal-Am (the first purpose), and about 60% of the project will be used for irrigation (the second purpose).³ Is this correct?
- b. What percentage of project costs does the Agency and the District expect will be recovered from Cal-Am (first purpose)?
- c. What percentage of project costs does the Agency and the District expect will be recovered from irrigation (second purpose)?
- d. Is the Agency and the District proposing a WPA for buyers of irrigation water (the second purpose)?
- e. If not, why not.
- f. If not a WPA, is the Agency and District proposing an agreement of any type with the buyers of the irrigation water (the second purpose) that will require those buyers to agree now that all future costs are "reasonable and prudent?"

8. Remaining hurdles

- a. If the WPA is approved by the CPUC (based on the 1/14/16 draft or modified to reflect CPUC concerns)

² Pure Water Monterey GWR Project Consolidated Final EIR, October 2015, page S-3.

³ $3500/(3500+5000) = 41\%$; $5000/(3500+5000) = 59\%$.

- i. What regulatory, financing, and other hurdles remain to construct and begin operation of the GWR?
 - ii. What would be the projected timeline for overcoming those hurdles?
 - iii. Taking those hurdles into account, what would be the projected timeline for construction and the commencement of operation of the GWR?
- b. If the WPA is not approved by the CPUC
 - i. What regulatory, financing, and other hurdles remain to construct and begin operation of the GWR?
 - ii. What would be the projected timeline for overcoming those hurdles?
 - iii. Taking those hurdles into account, what would be the projected timeline for construction and the commencement of operation of the GWR?

(End of Attachment 1.)

ATTACHMENT 2

CONCERNS WITH 1/14/16 DRAFT WPA

This attachment surfaces potential concerns with the 1/14/16 Draft WPA so parties can assess and address the concerns. The concerns are:

1. REQUESTED DELEGATION OF CPUC AUTHORITY AND RESPONSIBILITIES: The California Public Utilities Commission (Commission or CPUC) cannot delegate its ratemaking authority. The CPUC cannot delegate its responsibility to protect the ratepayers of regulated privately owned public utilities (e.g., responsibilities such as provision of adequate service, safety, reasonableness of rates). The authority and responsibility cannot be delegated to private companies (e.g., Cal-Am to review and comment on the Agency and District budgets). The authority and responsibility cannot be delegated to other government entities (e.g., Agency, District). The CPUC cannot agree, by its approval of the WPA, that now and for the next 30 to 40 years the CPUC shall have deemed to have agreed that all costs, expenses and rates determined by the Agency and District are “reasonable and prudent.” (1/14/16 Draft WPA, Section 16.)
2. BIND ALL FUTURE COMMISSIONS: The CPUC cannot bind all future Commissions for up to 30 or 40 years (e.g., to 2050 or 2060) to the costs, rates, and other results contained in the 1/14/16 Draft WPA. Each future Commission has its own authority and responsibility to protect ratepayers (e.g., service, safety, rate reasonableness) as each Commission determines necessary at that time. Even if the CPUC could attempt to bind future Commissions, it is unreasonable to do so in this case.
3. PREJUDICE OF PHASE 1: The schedule for this proceeding contemplates a combined decision on Phases 1 and 2. It provides that a separate Phase 2

decision could be considered first if any party making a motion for an earlier Phase 2 decision can “explain how the Phase 1 and Phase 2 issues, which appear to be substantially if not inextricably intertwined, would be reasonably and fairly treated in separate decisions.” (November 17, 2015 Ruling at 11.) No such motion has been filed, and there is not yet any convincing showing that the Phase 1 and Phase 2 issues can be reasonably and fairly treated in separate decisions, and that an early Phase 2 decision will not prejudice the Phase 1 outcome. Parties may, of course, file a motion to show that a decision on the WPA, now scheduled for Phase 2, could be made in 2016, ahead of the Phase 1 MPWSP application, in a manner that does not prejudice the Commission’s decision regarding the MPWSP, and is consistent with the Commission’s responsibilities and jurisdiction.

4. INADEQUATE LEGAL PROCESS OF AGENCY AND BOARD: To the extent the CPUC might consider relying on cost, rate, and other determinations reached by the Agency and Board (without further technical or legal process at the CPUC), the technical and legal processes of the Agency and the Board appear at this time to be inadequate to meet the requirements of the CPUC in fulfilling its responsibilities (e.g., due process, testing of evidence in public hearings, legal briefs, appeals of decisions).
5. PRICE: The draft WPA does not state a fixed price.
6. PRICE FORMULA: The formula in the draft WPA for determining the water rate fails to account for potentially important factors (e.g., actual versus expected water sales, water losses)
7. SOFT CAP: There is no substantial difference between no price cap and a “soft cap.” (See March 22, 2016 proposed Rebuttal Testimony of Stoldt at 6: 16-20.) Either way, the Agency and District propose in the 1/14/16 Draft WPA that they have the authority to raise the water rate for GWR water, including

above the soft cap. The 1/14/16 Draft WPA requires the Company to ask the CPUC to flow-through those higher costs and, as now drafted, requests the CPUC to predetermine that all water rates set by the Agency and District are “reasonable and prudent.” (1/14/16 Draft WPA, Section 16.) This request is inconsistent with the CPUC’s ratemaking responsibility and authority, and statutory requirement under California Public Utilities Code Section 451 to ensure that utilities provide adequate facilities at just and reasonable rates.

8. UNKNOWN COSTS: The 1/14/16 draft WPA requires that the Agency and Board obtain insurance. (Draft WPA, Section 28.) The requirements of that insurance are not included (i.e., Exhibit D to the draft WPA is blank with regard to the amounts of insurance and other details). This becomes a “blank check” for the Agency and District to possibly later bind themselves to obtaining unreasonably broad coverage or high levels of insurance (to protect themselves from liabilities and obligations under the WPA, but at the expense of Cal-Am ratepayers).
9. LACK OF INCENTIVES: The 1/14/16 Draft WPA provides that the Agency will be responsible for the design, construction, operation, and ownership of the GWR facilities. It provides that the Agency and the District will establish project fixed and variable costs and the Company Water Rate, and the CPUC, by its approval of the WPA, shall be deemed to have agreed that all such costs and rates as “reasonable and prudent.” (1/14/16 Draft WPA, Section 16.) There are no provisions, however, to address incentives for how the Agency and District will ensure that fixed and variable costs are reasonable.

For example, with the Agency having sole responsibility for the GWR facilities, but the Agency and the District having 100% assurance that the CPUC will accept their results and those results will be paid by Cal-Am ratepayers, how can the CPUC and Cal-Am ratepayers be confident that project construction, operation, and maintenance will be reasonable and

prudent (e.g., avoiding the acceptance of contractor overbids, excessive cost overruns, unreasonable change orders, inefficient operations all because cost recovery is guaranteed)? Said differently, with a rate recovery guarantee, what incentives do the Agency and the District have to get the lowest reasonable costs for project construction, ownership, operation, and maintenance from any private companies it hires, or from its own employees?

Many government agencies, including the CPUC, have had experience with unscrupulous private companies (e.g., CPUC experience with private firms during the energy crisis; regulated public utilities using money approved in a general rate case for purposes other than contemplated by the Commission, resulting in unsafe conditions). As now drafted, the 1/14/16 Draft WPA fails to provide confidence to the CPUC and Cal-Am ratepayers that the GWR will be built, owned, maintained and operated as efficiently and cost-effectively as reasonably possible, and as required for costs and rates to be reasonable and prudent. As hard as any government agency may try, no agency can guarantee it cannot be fooled by unscrupulous stakeholders, contractors, or others. This is not a criticism of the Agency or the Board, any more than it is of the CPUC or any other government agency. It is to express a concern relative to the degree of confidence the CPUC and Cal-Am ratepayers can place in the proposed process established within the 1/14/16 Draft WPA (including the degree of transparency, technical and legal due process, checks and balances, incentives to promote reasonable behavior and outcomes, and, finally, court review).

10. UNBALANCED AND INEQUITABLE REQUEST FOR PREAPPROVAL: It is unbalanced, unreasonable, and inequitable to require a WPA for Cal-Am, with a guarantee that Cal-Am ratepayers will pay all GWR costs proportional to the water sold to Cal-Am, when there is no similar requirement for other buyers of GWR water.

11. CONSIDERATION OF ALTERNATIVES: We encourage the parties, including Cal-Am, to consider alternatives in addition to the WPA since, even if the Commission were to consider approval of an amended WPA proposal that addresses the concerns above, the project is unlikely to be constructed before the end of 2016 when the State Water Resources Control Board (SWRCB) Cease and Desist Order (CDO) regarding withdrawals from the Carmel River is scheduled to take effect. Cal-Am should consider alternatives as an interim or complementary solution including a WPA using technologies such as atmospheric water condensers, or other means to reliably and at reasonable costs supply water to Cal-Am's Monterey peninsula customers, particularly during the peak summer season. Cal-Am may propose alternatives in addition to the GWR WPA, and the Commission will make every effort to consider reasonable proposals consistent with the Commission's jurisdiction and regulatory responsibilities in a timely fashion, taking into consideration the SWRCB's CDO timeline.

12. Commissioner Sandoval will discuss at the April 11, 2016 Prehearing Conference her intent to present a resolution for consideration by the Commission stating the Commission's support for extending the timeline for the CDO imposed by the SWRCB to the 2020 date proposed by the MPWSP applicant and several mayors in light of the Commission's and parties' substantial efforts to reduce water usage in the Monterey Peninsula and the milestone achievements in the Commission's MPWSP proceeding. Commissioner Sandoval will present this resolution for her colleagues' consideration in May 2016.

(End of Attachment 2.)